No. 88-1649

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In the Supreme Court of the United States

OCTOBER TERM, 1988

L & B CORPORATION, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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15 pp

QUESTION PRESENTED

Whether the refrigerated structures placed in service by petitioners in 1979 and 1980 were "building[s]" within the meaning of 26 U.S.C. 48(a)(1)(B), rendering them ineligible for the investment tax credit.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-21) is reported at 862 F.2d 667. The opinion of the Tax Court (Pet. App. 25-59) is reported at 88 T.C. 744.

JURISDICTION

The judgment of the court of appeals (Pet. App. 22-23) was entered on November 25, 1988. A petition for rehearing was denied on January 6, 1989 (Pet. App. 24). The petition for a writ of certiorari was filed on April 4, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners were partners in three partnerships that owned and operated several cold storage warehouse facil-

ities in Nebraska and Iowa (Pet. App. 2, 4). They claimed investment tax credits based upon their distributive shares of the partnerships' cost of constructing or improving several refrigerated structures that were placed in service in 1979 and 1980 (*id.* at 3). Each structure is constructed of conventional building materials – including poured concrete footings and floors, walls of concrete block or insulated metal panels attached to steel framing, and an insulated steel decking roof. Beneath the concrete floor is a six-inch layer of insulation on top of a layer of gravel. Pipes within the gravel layer remove waste heat from the compressors and prevent frost build-up that could cause the floor to buckle. Each structure contains refrigeration equipment (coils and blowers) and storage racks, which can be removed without damaging the structure. *Id.* at 4-5, 29-31.

The predominant use of the facilities is to "blast freeze" freshly cut meat delivered to the facilities by meat packers. Upon arrival, the meat is placed on pallets and taken into the structures for rapid freezing. The meat is then moved to other refrigerated areas for storage until shipment. The facilities are also used to store frozen food products. The meat and other food products are transported to and from the various refrigerated compartments by employees using fork lifts. Pet. App. 5-6, 36-37.

On audit, the Commissioner determined that an investment credit for the costs of the refrigeration equipment should be allowed. He disallowed the credit for the costs of constructing the structures themselves, however, reasoning that they were "buildings" ineligible for the credit and also that they were not used in manufac-

turing, production, or extraction, as required by 26 U.S.C. 48(a)(1)(B)(i). Pet. App. 3, 38-39.[1]

2. Petitioners sought redetermination of the resulting deficiencies in the Tax Court, which ruled in favor of the Commissioner (Pet. App. 25-59). The court first held that the refrigerated structures were not "buildings" within the meaning of Section 48(a)(1)(B) and therefore were not disqualified from the investment tax credit on that ground (Pet. App. 41-49). The court reasoned that, while the structures looked like buildings (*id.* at 44-45), they did not function as buildings because they did not provide working space for employees (*id.* at 47). The Court nonetheless denied petitioners' claimed investment credit on the ground that none of the property was used in a qualifying production activity as required by Section 48(a)(1)(B)(i) (Pet. App. 49-54).

3. The court of appeals affirmed in part and reversed in part (Pet. App. 1-21). First, contrary to the Tax Court, the court held that the refrigerated structures were "buildings" and therefore ineligible for the investment credit (*id.* at 8-16). The court rejected as "unduly restrictive" the Tax Court's view that a structure could not function as a building if it did not primarily provide working space for humans (*id.* at 9). Citing the definition

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[1] The Commissioner also denied the credit for the cost of the truck turnarounds and railroad tracks added to the facilities, because they were not used in an activity qualifying under Section 48(a)(1)(B)(i). Because the structures did not qualify as property eligible for the investment tax credit ("Section 38 property"), the Commissioner also determined that petitioners were not entitled to use the double declining balance method of depreciation, pursuant to Sections 167, 1250 and 1245 of the Internal Revenue Code (26 U.S.C.). See Pet. App. 55-59.

of "building" in Treas. Reg. § 1.48-1(e)(1), and the legislative history that instructs that the term "building" be given its commonly accepted meaning, the court concluded that "a structure functions as a 'building' if it provides shelter for significant machine or animal activity or if it provides working space for humans" (Pet. App. 12). The court held that the refrigerated structures in this case function as buildings because they provide shelter for significant machine activity, as well as working space for the employee activity required (*id.* at 12, 21).

The court of appeals also disagreed (Pet. App. 17-21) with the Tax Court's conclusion that the facilities were not used as an integral part of a qualifying activity, *i.e.*, "manufacturing, production, or extraction," which had been the basis for the Tax Court's complete denial of the claimed investment credit. The court of appeals held that the blast freezing of fresh meats constitutes part of "the processing of meat" within the meaning of the relevant Treasury Regulations (see *id.* at 17-20). Accordingly, the court concluded that the portions of the warehouse facilities that were not "buildings," *i.e.*, the truck turnarounds and railroad trackage, did qualify for the investment credit as "other tangible property" used as an integral part of a qualifying activity, and it reversed the Tax Court to that extent (*id.* at 21).[2]

ARGUMENT

The court of appeals correctly rejected petitioner's claim of entitlement to an investment credit for its refrigerated structures. The decision below does not conflict with any decision of this Court and does not conflict in

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[2] The government has not sought certiorari on this issue.

result with any decision of another court of appeals. Moreover, the issue presented here lacks continuing importance because the investment credit provisions were repealed in 1986 and do not apply to property placed in service after 1985. Accordingly, review by this Court is not warranted.

1. The investment tax credit was repealed by Section 211(a) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2166. Pursuant to that statutory change, the investment tax credit is not available for property placed in service after December 31, 1985. See 26 U.S.C. 49 (Supp. V 1987). Thus, the question presented in this case – the definition of a "building" under 26 U.S.C. 48(a)(1)(B) – is relevant only to a dwindling number of cases concerning property placed in service prior to 1986.

Petitioners argue (Pet. 18-19) that the correct standard for determining whether a structure is a "building" retains prospective importance for purposes of deciding whether the structure is eligible for accelerated depreciation. The rules applicable to depreciation of tangible property used in a trade or business have been substantially revised since the tax years involved in this case. See 26 U.S.C. 168 (1982 & Supp. V 1987).[3] These new rules specify that "nonresidential real property"

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[3] The new accelerated depreciation rules were established by Sections 201-214 of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 203-241. With limited exceptions, those rules apply to property placed in service after December 31, 1980. The accelerated depreciation rules were changed again, effective for property placed in service after December 31, 1986, by Section 201 of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2121-2142.

(§ 168(e)(2)(B)) is depreciable by the straight line method with a recovery period of 31.5 years, while other property may be eligible for accelerated depreciation (§§ 168(b)(3)(A) and 168(c)(1)). This case, however, does not involve the definition of "nonresidential real property" in the depreciation provisions, and there is no basis for necessarily equating that definition with the definition of "building" in the repealed investment tax credit provisions. Thus, this case does not present an opportunity to clarify the law on any question of prospective importance.

2. The court of appeals correctly held that the refrigerated structures at issue here were "buildings." The investment credit provisions of the Internal Revenue Code applicable to the tax years at issue here, 26 U.S.C. 38, 46 and 48, allowed a tax credit for investments in certain kinds of depreciable property. Section 48(a)(1)(A) provided that tangible personal property (other than an air conditioning or heating unit) qualified for the credit. Section 48(a)(1)(B) authorized a credit for "other tangible property" used in certain activities such as manufacturing or production, but this subsection expressly excluded "a building and its structural components." The statute contained no definition of "building," but the term was defined by Section 1.48-1(e)(1) of the Treasury Regulations as follows:

> any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses,

> barns, garages, railway or bus stations, and stores.

Based on this regulatory definition and the relevant legislative history, the courts developed a two-part test to determine if a structure was a building: (1) the "appearance" test, *i.e.*, whether the property resembled a building by enclosing a space with walls and a roof; and (2) the "function" test, *i.e.*, whether it provided shelter, housing, working, office, parking, display, or sales space. See, *e.g.*, *Consolidated Freightways, Inc.* v. *Commissioner*, 708 F.2d 1385 (9th Cir. 1983); *A.C. Monk & Co.* v. *United States*, 686 F.2d 1058, 1061 (4th Cir. 1982); *Yellow Freight System, Inc.* v. *United States*, 538 F.2d 790 (8th Cir. 1976).

As the court of appeals explained (Pet. App. 12), the refrigerated structures involved here are reasonably regarded as "buildings" under this approach. The legislative history indicates that Congress intended that the term "building" "is to be given its commonly accepted meaning, that is, a structure or edifice enclosing a space within its walls, and usually covered by a roof." See H.R. Rep. No. 1447, 87th Cong., 2d Sess. A18 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 154 (1962). The structures here are enclosed with walls and a roof, and they function as a warehouse, which is specifically mentioned in the regulation and in the legislative history as a kind of building. See H.R. Rep. No. 1447, *supra*, at A18; S. Rep. No. 1881, *supra*, at 155. The structures clearly provide shelter for the refrigeration equipment and the employees who move the meat during the process of freezing, storing, and shipping it.

The Tax Court's holding that the structures in this case are not "buildings" rests upon its view that "a major focus of inquiry is whether the structure provides working space for employees which is more than merely incidental to the primary function of the structure" (Pet. App. 45 (internal quotation omitted)). Under that approach, the court found that they were not buildings because they did not provide for "significant human activity" within (*id.* at 46-47). The court of appeals correctly rejected this interpretation of the investment tax credit provisions. In the words of the court of appeals, "[n]othing, either in the Code or in the Regulations, implies that this space must be primarily occupied by humans to qualify as a building" (*id.* at 9). To the contrary, both the regulation and the legislative history make clear that edifices that primarily provide shelter for goods or machinery, such as warehouses and garages, can qualify as buildings. Thus, the court of appeals applied the correct legal standard to the undisputed facts of this case, and it correctly held that the refrigerated structures were buildings. It therefore did not err in affirming the Tax Court's denial of the claimed investment tax credit for the structures.

3. Contrary to petitioner's contention (Pet. 12-13), it is not appropriate for this Court to grant certiorari here to resolve an asserted conflict with *Munford, Inc.* v. *Commissioner*, 849 F.2d 1398 (11th Cir. 1988). In that case, as in this one, the court of appeals affirmed the Tax Court's holding that a refrigerated structure did not qualify for the investment tax credit. Unlike this case, however, the court there accepted the Tax Court's conclusion that the refrigerated structure was not a "building" (849 F.2d at 1402-1404); instead, the court affirmed the Tax Court's denial of the credit because it held that the struc-

ture could not qualify as "tangible personal property" under Section 48(a)(1)(A) because it was an "inherently permanent structure" that was not "in the nature of machinery" (849 F.2d at 1404-1407).[4] Thus, the Eleventh Circuit, the Eighth Circuit, and the Tax Court have all rejected the claim that refrigerated structures are eligible for the investment tax credit under the statute applicable to these tax years, albeit upon different rationales. This difference in reasoning to reach the same result does not present a conflict in the circuits that warrants the attention of this Court. Moreover, as noted earlier (point 1, *supra*), to the extent this difference in reasoning might lead to different results in another factual context, review by this Court is not appropriate because the investment tax credit has been repealed and the definition of "building" in the investment credit provisions is accordingly of diminishing importance.

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[4] The taxpayer in *Munford* relied exclusively on Section 48(a)(1)(A); it did not argue, as did petitioners here, that the structure qualified as "other tangible property" under Section 48(a)(1)(B).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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